

DOCKET SECTION

BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, D.C. 20268

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POSTAL RATE COMMISSION
WASHINGTON, D.C. 20268

POSTAL RATE AND FEE CHANGES, 1997

Docket No. R97-1

INITIAL BRIEF OF THE AMERICAN PUBLIC POWER ASSOCIATION

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I. NATURE OF THIS CASE

This rate case is a most unusual case. The OCA's Initial Brief, Section I, explains that the USPS has inadvertently filed for increased rates which, as facts now available clearly demonstrate, would generate revenues far in excess of those required to meet statutory standards. Consequently, this case provides the Commission with broad discretion to make rate reductions where present rates are out of line and inconsistent with statutory standards. The American Public Power Association (APPA) opposes all of the proposed increases in card rates, and requests reductions in all card rates (Single-piece, Basic presort, and all Automation categories). Past increases in post card rates, and the proposed one-cent increase, have and will continue to impose damage upon the public which needs a low cost means of communication. The record herein demonstrates that all of the present rates for post cards are excessive and should be reduced.

II. IMPACT UPON THE PUBLIC

Throughout most of our Nation's history, our government, recognizing that communication is vital to its citizens, has provided the public with a very minimal cost means of communication - the post card. In the years of the Great Depression, the penny post card was the essential means of communication among many families. In today's world, the telephone provides a widespread alternative to written communications, but written communications still occupy a central core in our society.

Many county, city, and town governments provide electricity, gas, water, and sewage services to their residents, and many use

cards to bill customers for those services. Tr. 20/10246. The cost of the services provided includes the billing cost. Thus, the general public bears the cost of mailing post cards and receiving billing cards. Some small businesses also use cards for billing purposes. There is a broad array of governmental and commercial entities which try to provide basic services to the public at the lowest possible cost, and where possible, use cards to achieve that objective. These public service and commercial entities will be severely impacted by the proposed increases in card rates. (Id.) The USPS should be directed to make available a very low cost postal service for government agencies and small businesses to bill customers for essential services rendered.

Card billers have already suffered major recent increases in their postal costs, as a result of the reclassification in Docket MC95-1; and the USPS proposes, in this case, to impose a second round of increases which will adversely impact the customers who receive electricity, gas, water and sewer services from municipally owned service providers, and other small businesses. Tr. 20/10247.

The eligibility conditions for Automated cards impose obstacles to automation which have prevented many of the mailers, which use cards for billing, from having access to the Automated rate categories. (Tr. 20/10247). The stringent automation eligibility conditions, combined with abolition of the 3 and 5-digit and carrier presort rate categories, resulted in a very substantial, and unanticipated, postal rate increase in 1996 for most card billers. Government agencies providing electricity, water and sewer services, serve all users in a market area, and

have a very high density for their billing mail. Most of them were able to use the carrier route presort rate of 16 cents, prior to reclassification. As a result of reclassification's elimination of the carrier presort rate category, and the imposition of conditions which effectively barred many card bills from eligibility for automation categories, many of the users of cards for billing experienced a dramatic rate increase in 1996 - 12.5% - from the carrier presort rate of 16 cents, to the Basic Presort rate of 18.0 cents. (Tr. 20/10248) The USPS is now requesting a totally unjustified 19 cent rate for Basic Presort.

The present single-piece rate of 20 cents for cards is far out of line with the historical post card/letter relationships, and excessive by the statutory standards established by the Postal Reorganization Act. The present Basic Presort rate of 18 cents is also excessive by those statutory standards. The Commission should reject the proposed increases in the single-piece and presort card rates. All of the existing card rates are excessive and should be reduced, not increased.

III. RATE HISTORY RESTORE THE POSTCARD/LETTER RELATIONSHIP

Throughout most of our nation's history, the Federal government provided post cards as the lowest cost means of public communication. The long standing, traditional, "penny post card", in effect for about 65 years, from 1886 until 1918 and from 1920 to 1952, was only one-half or one-third of the letter rate. See the history of card and letter rates at Tr. 20/10249-10251.

Since the Postal Service became "self sustaining", the basis

for increases in postal rates has been inflation. The Postal Service is a very labor intensive service industry. Its contracts with the postal unions require annual cost of living adjustments, and the salaries of supervisory employees are also adjusted annually to reflect COLA. Those increases in labor costs, offset by any increases in productivity, must be passed on through increases in postal rates. But the proper policy to recover the cost of inflation is an across-the-board percentage increase in all rate classes and categories, not the very discriminatory increases implemented in R90-1, where the Commission approved a 27% increase in post cards and a 15% increase in First Class letters. See Tr. 20/10252. The one cent increase proposed in this case for cards compounds the inequitable base established in R90-1 and earlier actions, and it should be rejected. An 18 cent card rate would restore the historical relationship and provide the public with an inexpensive means of communication.

IV. THE RATE MAKING CRITERIA SUPPORT A DECREASE IN CARD RATES

Section 3622 (b) of the Postal Reorganization Act provides the criteria which the Commission must address in establishing "fair and equitable" postal rates. The first factor to be evaluated is "the value of mail service provided". §3622(b)(2). An examination of the relative values and costs of letters and cards demonstrates that the present 20 cent card rate is excessive by the statutory criteria, and that rate should be reduced, not increased.

A. The Value of Privacy - The primary difference in value between First-class Letters and Standard Letters is that First-

class letters are private and sealed against inspection. But a card, like Standard mail, is open to public view; a card provides no possibility of private communication. Privacy has value in the economic world, and the card has no privacy value. In the first postal rate case, the Administrative Law Judge observed that post cards "cannot be used to enclose valuable contents, they don't enjoy privacy, the message that can be sent is limited..." Docket No. R71-1, 3/A/394. The Commission should give recognition to the privacy/no privacy relationship in determining a reasonable letter/card relationship.

B. Communication Quantity - The quantity of information that can be conveyed by a one ounce (4 double-sided pages) letter is from 6 to 24 times as much as information that can be written on a card. (Tr. 20/10256). A means of communication which has from 4 to 17 percent of the capacity of a letter should not have a postal rate that is 60+ percent of the letter rate.

C. Demand Price Elasticity - One of the most significant quantitative measures of the value of a service provided, in establishing cost markups and coverage, is the price elasticity of demand. (USPS-T-30, p. 4) As witness O'Hara has testified, the lower the own-price elasticity, the higher is the value of the service provided. The "Long-run Own-Price Demand Elasticities", as reported by witness O'Hara (USPS-T-30 p.5) are as follows:

First-class letters	-0.232
Private cards	-0.944

Private cards (those not printed by the USPS) are 4 times as price elastic as First-Class letters; that indicates that the

service provided for cards is in the range of one-fourth of the letter value. The dramatic difference in demand price elasticity clearly requires a far lower cost coverage for cards than for letters. USPS regularly uses "Ramsey Pricing" as a methodology for designing rate mark-ups from variable costs. The testimony of OCA Witness Roger Sherman demonstrates that the total revenue per piece that would be generated by the proposed card rates (19.72 cents) far exceeds (by almost 6 cents per piece) the highest permissible revenue under Ramsey pricing (13.97 cents). See OCA-T-300, p. 21. That testimony also demonstrates that, with the proposed card rates, the average "Welfare Loss" per dollar of contribution for cards, 0.28, would exceed the Welfare Loss for every other subclass except for Express mail. (Id. p. 35).

These aspects of "value" - privacy/lack of privacy, quantity of communication, tremendous differences in demand price elasticity and totally out of line Ramsey pricing impacts - demonstrate that a card does not have 60+% of the value of a letter. Increases in the rates for cards are totally unjustified. The present 20 cent single-piece rate for cards is quite excessive, by every statutory standard, as compared with the proposed 33 cent Single piece First-class letter rate. The proposed increase in the single-piece card rate should be rejected; an 18 cent card rate, and a 33 cent letter rate, would be far more consistent with the historical relationship (Tr. 20/10250) and with statutory standards.

D. Rate Simplification - One criterion that has rarely been addressed is that of Rate Simplification. §3622(b)(7). The USPS recently filed Errata to the testimony of its witness Miller,

addressing the response of the public to a "two-stamp" system that would result from the CEM proposal. The fact is that under the present system of first-class rates, the public, in order to avoid overpaying for mailing a letter or post card, must have an inventory of 3 stamps - 32 cents for the first ounce of a letter, 23 cents for the second ounce, and 20 cents for a card. Other parties have presented evidence that the 23 cent incremental ounce rate far exceeds incremental per-ounce letter costs. (See Tr. 21/10831, 10837-8). With 33 cents for the first ounce, and 18 cents for each additional ounce, a one pound letter would cost four times as much as a Standard (A) ECR package. Establishing an 18 cent stamp, which could be used for additional ounces of letters, for cards, and for CEM, should the Commission endorse that rate category, would be a simplification that could be a great convenience to the public.

In short, privacy, communication quantity, price elasticity, and rate simplification all support an 18 cent stamp.

V. WORKSHARING CARD RATES ARE EXCESSIVE

A. Classification History - Section 3622(b)(1) of the Postal Reorganization Act requires that postal rates be fair and equitable, and Section 3623(b)(1) requires that a fair and equitable classification schedule be established. One of the problems that has plagued the issue of setting rates for "work sharing" first-class mail is how to apply those statutory standards. Section 3622(b)(3) requires attribution of costs to each "class of mail" or "type of mail service". The USPS and the Commission have, over the years of regulation, created two

additional "classifications" with different standards - "subclasses" which require cost attribution, and "rate categories" which allow arbitrary cost calculations and the prescription of rates that will subsidize other "rate categories".

Docket No. MC73-1 - In the first postal classification case, the "Interim" Domestic Mail Classification Schedule (DMCS) was established, and made effective July 6, 1975; it included a bulk presort first-class mail service which was referred to by all parties as a "subclass". A contemporary Postal Study, published by the House Committee on Post Office and Civil Service, December 1, 1976, recommended creation of a broader Basic and Carrier Presort "subclass". (See Report, p. 54).

Docket No. MC76-5 - In the major Mail Reclassification case, the permanent DMCS was established. In the Commission's decision, issued November 29, 1978, and adopted by the Governors, effective April 30, 1979, First Class Mail, DMCS 100, was expressly divided into 4 subclasses: Regular Mail, Postal and Post Cards, Presorted Mail, and Priority Mail. Each of those subclasses had its own Rate Schedule; rates for Presorted Mail were shown on Rate Schedule 101.

Docket No. R80-1 - In the next postal rate case, the Commission declared that the Presorted Mail was merely a "rate category", totally ignoring the DMCS and Rate Schedule 101.

Docket No. MC83-2 - The USPS proposed to create Zip+4 as a new Subclass of First-Class Mail. The Commission rejected that proposal, but expanded DMCS 100 First Class Mail to include Zip+4 as rate categories in each of the Subclasses - Regular Mail, Post and Postal Cards, Presorted Mail, and Priority Mail.

Docket No. R84-1 - The Commission perceived that having Presorted Mail identified as a "Subclass" in the DMCS, with a separate Rate Schedule, jeopardized its ability to recommend rates which require business mail to subsidize personal mail. So the Commission, without any notice, rewrote DMCS 100 to reduce Presorted Mail to a "rate category" of Regular Mail and Post and Postal Cards, and deleted Rate Schedule 101.

B. A Sensible Approach - One common-sense approach to pricing is to treat single-piece and work-sharing first-class mail as two separate services. (See OCA T-300, p.347). In the new Standard Mail class, those kinds of services are identified as "subclasses", but such a formal classification is neither a necessity nor a criterion for fairness. As MMA witness Richard Bentley has pointed out, although First-class Basic presort is characterized as a rate category, and Standard A ECR is a "subclass", the two types of mail have many similarities in terms of physical characteristics, the manner of mailers' work-sharing, the manner in which they are processed, and their ability to yield cost savings to the Postal Service. (See 21/11160-1). Section 3622b(6) requires that the degree of preparation of mail, performed by mailers, be taken into consideration in establishing fair and equitable rates. The USPS has recognized that factors such as bulk versus single-piece entry, automation compatibility, and customer preparation of mail, are factors to be given consideration in designing rates. (See Docket No. MC95-1, testimony of Charles McBride, USPS T-1, pp. 25, 26, 28, 29, 32, 33, 41, 44, 48, 51, 52.)

In the first judicial decision to review a postal rate case,

National Association of Greeting Card Publishers v. USPS, 569 F.2d 570, 585 (CA-DC 1976) the Court stated:

Under the subsection [3622(b)(3)] **each service** must bear the postal costs "attributable to [it]" and in addition must also bear that portion of all other costs "reasonably assignable to [it]". Thus, the very words of subsection (b)(3) disclose its concern that **each class of mail and postal service** should shoulder all the postal costs that may be traced to the provision of that class or service. (Emphasis added)

Although that Court decision was ultimately vacated on procedural grounds, (see Associated Third Class Mailers Ass'n v. USPS, 662 F.2d 767 (CA-DC 1980), the perception that fair and equitable rates requires recognition of cost responsibility for each kind of service provided remains incisive. The Commission should recognize that service provided to the public, and service provided to bulk mailers, who must meet very stringent mailing eligibility conditions, are quite different services, each of which should bear its directly attributable costs and a reasonable share of system costs.

(1) **Cost coverage** - In the last three rate cases, R87-1, R90-1, and R94-1, the Commission has reluctantly approved higher cost coverages for First-class mail than it considered appropriate, in order to avoid recommending higher Third-class rates. (See R87-1, pp.402-3; R90-1, pages IV-33-4, ft. 16; R94-1, p.IV-16). But in this case, it is perfectly clear that the proposed rates would generate revenues substantially in excess of correct revenue requirements. Consequently, the Commission has the opportunity to reject some proposed rate increases, and to recommend some rate reductions, in order to bring cost coverages back in line.

In the case of "worksharing" cards (the aggregate of presorted

and automated cards) the projected cost coverage is 184%. (Exhibit USPS-30B, Revised, p. 43). That is a cost coverage only slightly below the 200% cost coverage for worksharing letters and is clearly out of line.

(2) **Unit Contributions to Institutional Costs** - For years, there has been a significant theoretical split between the Postal Service and the Commission regarding what benchmark to use for calculating "worksharing discounts" for presorted First Class mail. The Postal Service has advanced a totally hypothetical and unacceptable "cost avoidance" methodology that ignores actual recorded cost differences. The Commission has consistently rejected that "cost avoidance" methodology, and developed its "Appendix F" "cost difference" methodology. But the Commission's "cost difference" methodology also excludes from consideration many significant and substantial, recorded, cost differences between mail prepared by mailers to meet presort and automation conditions, and mail delivered into the postal system by the general public.

Everyone familiar with the operations of the postal system knows that bulk, presorted mail imposes far less cost burdens on postal system operations than single-piece mail. Postal carriers must pick up general public mail from mail drops, mail boxes, and the front desks of businesses. Those bags and boxes of single-piece mail must be carried by trucks to originating post offices, where mail is dumped on culling racks; pieces that can't go through the facer/cancelers are pulled out of the stream for separate handling, and the remaining pieces go through facer/cancelers, and must be carried to the outgoing sorting operations where they are

sorted to destination sectional centers. (See Tr. 21/11172-3). All of those requirements - to collect and process non-work-sharing mail - impose major cost burdens on the postal system - labor time by carriers and in-office workers, investments in, and repair, maintenance, and replacement of, trucks, mail boxes, buildings and equipment - costs for which single piece mail is responsible. Mail presorted to destination post offices, and delivered in trays to loading docks, makes no use of the retail postal system for the purchase and sale of stamps, and bypasses almost all of the collection and out-going mail processing operations. Leaving aside the complex "cost avoidance/cost difference" techniques, **fairness** dictates that the unit per-piece contribution to "system" costs by presorted cards should not exceed the unit per-piece contribution by Single-piece cards.

The Commission has long recognized that unit contributions to institutional costs are a valid means of avoiding cross subsidization. See Decision, MC95-1, pages 3037-9. The estimated total Unit Cost of Single Piece cards is 11.2429 cents, and Presort cards is 7.7568 cents. (USPS-T-29C, p. 1) The USPS proposes a 21 cents single-piece card rate, which would provide a 9.75 cent contribution to system costs, and a 19 cents Basic Presort rate, producing a unit contribution to system costs of 11.24 cents. If one fact is absolutely clear, it is that presorted mail imposes far less cost burden on the postal system than single-piece mail, and that the unit per-piece contribution to system costs by a presorted piece should not exceed the unit contribution of comparable single piece mail. The unit contributions proposed by the USPS are totally

out of line. An 18 cent single-piece card rate would make a unit contribution to system costs of 6.76 cents; a 14.5 cent Basic Presort card rate would make a similar unit contribution (6.74) even though a presorted card imposes far less burden on the system than the single-piece card. As a "transition", the Basic Presort rate could be set at 15 cents, representing a work-sharing "discount" of 3 cents, which makes a small subsidy to the single piece rate. Witnesses Richard Bentley (MMA-T-1) and James Clifton (ABA/EEI/NAPM-T-1) have analyzed cost differences between single-piece and presorted mail, and their analyses clearly support a 3 cent differential ("discount") for worksharing cards.

- VI. REVENUE IMPACTS OF CARD RATE REDUCTIONS
WILL BE MINIMAL

The projected Before-Rate-increase Total Cards revenue for Fiscal 1998 is \$1,059,843,000 (Exh. USPS-30A) and the After-Rates total revenue is \$1,088,979,000 (Exh. USPS-30B), an increase in revenue of only \$29,136,000. A one cent reduction in the card rate would result in a maximum loss of revenue of at most \$29 million, amounting to a revenue reduction of about 1.3%. With the high own price elasticity, a reduction in card rates could increase volumes, resulting in little or no revenue loss. In the context of the significant profits reported by the Postal Service for the last three fiscal years, a 2 cent card rate reduction, generating at most a 2.6% reduction in revenues, would be inconsequential.

The OCA Response to Notice of Inquiry No. 5, and its Initial Brief, First Section, demonstrate that the USPS projection of revenue requirements for the Test Year are excessive. The

Commission has significant discretion as to what adjustments are to be made to bring projected revenues into line with projected costs. The reductions in card rates requested by APPA would have minimal impacts and are clearly within the scope of the Commission's discretion to make adjustments in rates. Benefits to the public of across-the-board reductions in all card rates would be very substantial.

VII. PRESENT AUTOMATION CONDITIONS ARE BURDENSOME

The standard card used for billing customers for services rendered has an address stub that is too narrow to contain the complete 11 digit barcode required for eligibility for automation rate categories. (See Tr. 20/10268) Many users of cards for billing and other business purposes have not been able to qualify their cards for automation rates. Cards presorted to 3 or 5-digits or to carrier routes, do not go through the first rounds of automation processing at the originating sectional centers that send mail to 3 and 5-digit destinations. At the destination centers, where mail is sorted by automation equipment to carriers and to walk sequences, the first five digits of the automation code are irrelevant. Cards presorted to destination offices should be eligible for 5-digit and carrier sorted automation rates with only the last 6 digits of barcodes in the address. (Tr. 20/10263) An alternative, possibly a 4.25" x 7" card, should also be explored.

VIII. SUMMARY

A. Single-Piece Card Rate - APPA's recommended 18 cent single-piece card rate would be 54.5% of a 33 cent letter rate, consistent with the long standing letter/card historical relationship. Such

a rate relationship would also be far more consistent with the statutory standards, considering that letters have absolute privacy; cards have zero privacy. Cards have only a fraction of the communication capacity of a letter. Cards on average have only about 8.5% of the weight of a letter, and cards have 4 times the price elasticity of letters:

Comparison of Letters and Cards At APPA Recommended Rates			
<u>Criteria</u>	<u>Letter</u>	<u>Card</u>	<u>Card/Letter Ratio</u>
Rate	33 cents	18 cents	54.5%
Privacy	Sealed	Open	Zero
Communication	8 pages	1/3 page	5%
Weight	1 oz.	1/12 oz.	8.5%
Elasticity	-0.232	-0.944	400 %

B. Basic Presort Rate - APPA's recommended rate of 15 cents is far more consistent with the rate making criteria than the USPS proposed 19 cents:

Comparison of Mark-Ups of Cards At USPS Proposed and APPA Recommended Rates				
<u>Criteria</u>	<u>USPS</u>		<u>APPA</u>	
	<u>Single-piece</u>	<u>Presort</u>	<u>Single-piece</u>	<u>Presort</u>
Rate	21	19	18	15
Unit cost	11.243	7.757	11.243	7.757
Unit contribution	9.757	11.243	6.757	7.243

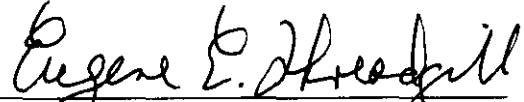
A Basic Presort rate of 15 cents would have a mark-up of total unit costs (7.7568 cents) of almost 100%. An 18 cent single-piece card rate would make a unit contribution to system costs of 6.8 cents; a 15 cent Basic Presort card rate would make a unit contribution of 7.2 cents, slightly higher than the single-piece unit contribution, even though a presorted card imposes far less burden on the System than the single-piece card. The present two

cent "discount" for basic presorted cards is punitive and fails to provide the rate differential required by the statutory standards. The Basic Presort "discount" should be increased to 3 cents.

C. Automation Eligibility - Although APPA has not made any broad scale analysis of the impact of automation conditions upon the use of cards for billing purposes, it is their perception that the problems of qualifying for automation have driven some card users to envelope use, and many of those which have continued to use cards have experienced significant increases in their postal costs. It would be in the public interest if the USPS would consider some modification of the Automation conditions for cards presorted to 5-digits and carrier routes, and delivered to a destination 3 or 5 digit postoffice, in order to allow those presorted cards to qualify for automation rate categories, without the full 11 digit barcode. It might also be useful to consider the ramifications of an enlargement of permissible cards to 7 inches.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I, Eugene E. Threadgill, counsel for the American Public Power Association, hereby certify that, on April 1, 1998, copies of the foregoing document have been served upon the USPS, the OCA, and upon all intervenors in accordance with the Rules of Practice.

